COLORADO FINANCIAL MANAGEMENT®

Economic & Market Review

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RE: Hold your nerve

It's getting ugly out there… the bad news is catching up with the down market. That makes this the hardest time to hold your nerve. Over the last few days and weeks we have seen evidence that the housing market is rolling over, and the index of leading economic indicators fell for the sixth month in a row. Business sentiment in Europe is falling, China's housing market is cracking, and the war in Ukraine shows no sign of ending. The energy crisis in Europe is crippling factory output. These are just some of the negative economic news and political stories.

Why then do we recommend holding on rather than selling and buying back in later?

We don't believe it's possible to time these moves on a consistent basis, and you have to get it right twice – selling and buying. We've already missed the right time to sell. That was last December or in January.

When everything is obvious, it usually isn't. Remember when we started 2022? We just came off a 6% GDP growth year in 2021 and consensus expectations were for 4% growth this year. Earnings growth was expected at 10% and interest rates were still very low. The market was trading at 21x estimated earnings, which is high but not completely crazy considering the whole of the evidence. There was no war, no energy shortage, unemployment was low, and we were finally coming out of the Covid pandemic.

Now everything looks awful as described above, but the primary change is that inflation is higher than expected and interest rates which have moved up about 3%. This lowers the present value of all assets and slows the economy, but will eventually reduce inflation. Many inflationary pressures have already slowed – notably oil and gas prices, but also nearly all commodities. Supply chain issues are getting better.

Short term rates have risen from 0% to 3% this year. The Fed has indicated they're going to push them to 4% to 4.5%, so they're 75% of the way there. We're much closer to the end than the beginning.

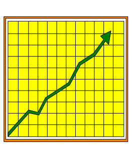
I don't mean to sugar coat it. The market could go lower. The next shoe to drop is earnings expectations. As mentioned above, at the beginning of the year estimates were for $225 this year. The estimate is now at $210 and about $225 for the next twelve months. With the economy slowing that seems unlikely. I've plugged in $200 and used a 16x multiple. Under that scenario the market bottom would be 3200, which is another 10% lower. That's also in line with historical bear markets, but the timing of both the fall and rise is improbable.

Thinking longer-term… unless the economic system has completely changed, earnings will reach $225 and then $250 and eventually $300; and the P/E ratio will revert to its historical average of 17x or 18x bringing the market back to its old high and beyond. It's really a question of time, not price.

I have said and will repeat, stable interest rates are a necessary but not sufficient requirement for the stock market to stabilize. Previously it looked like they were going to hover around 3%. That level appears to have been breached and the next logical level is 4%; but longer term rates are correlated with the economy. If the economy is strong, rates rise and vice-versa. With the economy beginning to slow, LT rates should stop rising – there just needs to be more evidence that inflation is coming down.

So if you're keeping score at home… watch the yield on the 10 year Treasury. Once it stabilizes, stocks should settle down. A new bull market probably won't start until there's more clarity on the economy and earnings. Just like the reversal to a bear market, the next bull market will start with a bang, and we won't know it's happened until sometime later.

I heard a good quote this week... Get comfortable being uncomfortable. I'm afraid we have a little more time left with this backdrop.



Looking forward to the return of happier returns,

Brad Bickham, CFA, CFP®

Partner | Chief Investment Officer

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Please update your transfer instructions and order new checks for your Schwab One account(s) by December 31, 2022.

The ABA routing number for Schwab One® accounts has changed from **031000053** to **031100157**. We're writing to let you know about this change, and to ask that you take steps to make sure that transfers and checks for your Schwab One account(s) noted above are processed successfully. **What this means for your account(s).**

As of December 31, 2022, Schwab will no longer honor Schwab One checks or electronic funds transfer (EFT) instructions that include or reference the former routing number. **Your next steps.**

We ask that you make some updates before December 31, 2022:

1. Make sure your Schwab One checks reflect the routing number **031100157**. If not, you can order new checks and deposit slips online:
   - Go to **schwab.com/checks** and log in.
   - Select your Schwab One account (referenced above) from the dropdown menu.
   - Click the "Debit Cards and Checks" link.

   Your new checks and deposit slips will include the correct routing number. Please destroy or securely discard the old checks and deposit slips.

2. When providing the routing number for electronic funds transfer (EFT) instructions (e.g., payroll direct deposit, Social Security direct deposit, utility bill, tax refund), please use the following routing number: **031100157**.

You may continue to receive notices from us periodically to ensure you have made the necessary changes detailed above.

Thank you for the opportunity to serve you. If you have any questions, please call your advisor directly, or call Schwab Alliance at **1-800-515-2157**.

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